

**KEYSTONE AREA EDUCATION
AGENCY 1**

**INDEPENDENT AUDITOR'S REPORTS
BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

JUNE 30, 2006

CONTENTS

OFFICIALS		1
INDEPENDENT AUDITOR'S REPORT		2-3
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)		4-10
BASIC FINANCIAL STATEMENTS		
	<u>Exhibit</u>	
Government-Wide Financial Statements:		
Statement of Net Assets	A	11-12
Statement of Activities	B	13
Governmental Fund Financial Statements:		
Balance Sheet	C	14
Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Assets	D	15
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds	E	16
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds to the Statement of Activities	F	17
Notes to Financial Statements		18-25
SUPPLEMENTARY INFORMATION	Schedule	
Required Supplementary Information:		
Statement of Revenues, Expenditures/Expenses and Changes in Balances – Budget and Actual – All Governmental Funds and Proprietary Fund		26
Notes to Required Supplementary Information – Budgetary Reporting		27
Other Supplementary Information:		
Nonmajor Governmental Funds:		
Combining Balance Sheet	1	28
Combining Statement of Revenues, Expenditures and Changes in Fund Balances	2	29
Schedule of Revenues by Source and Expenditures by Function – All Governmental Fund Types	3	30
Schedule of Expenditures of Federal Awards	4	31-32
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>		33-34

CONTENTS
(Continued)

INDEPENDENT AUDITOR’S REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133	35-36
--	--------------

SCHEDULE OF FINDINGS AND QUESTIONED COSTS	37-38
--	--------------

KEYSTONE AREA EDUCATION AGENCY 1

OFFICIALS

<i>NAME</i>	<i>TITLE</i>	<i>TERM EXPIRES</i>
Board of Directors		
Walter Pregler	President	2008
Francis Peterson	Vice President	2007
Gary Gassett	Member	2009
Merle Gaber	Member	2009
Robert Brown	Member	2008
John Ganshirt	Member	2007
Norman Miller	Member	2008
Bill Withers	Member	2007
John Perrenoud	Member	2009

Agency

Robert Vittengl	Administrator	
Bob Shaw	Director of Administrative Services and Treasurer	
Candace Brockmeyer	Board Secretary	
Audie Baumgartner	Business Department Team Leader	Indefinite

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Keystone Area Education Agency 1
Elkader, Iowa

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Keystone Area Education Agency 1 as of and for the year ended June 30, 2006, which collectively comprise the Agency's basic financial statements listed in the table of contents. These financial statements are the responsibility of Agency officials. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with U. S. generally accepted auditing standards, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards and provisions require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Keystone Area Education Agency 1 at June 30, 2006, and the respective changes in financial position and cash flows, where applicable, for the year then ended in conformity with U. S. generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated November 9, 2006, on our consideration of Keystone Area Education Agency 1's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 4 through 10 and 26 through 27 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Keystone Area Education Agency 1's basic financial statements. We previously audited, in accordance with the standards referred to in the second paragraph of this report, the financial statements for the three years ended June 30, 2006 (none of which are presented herein) and expressed unqualified opinions on those financial statements. Other supplementary information included in Schedules 1 through 4, including the Schedule of Expenditures of Federal Awards required by U. S. Office of Management and Budget (OMB) Circular A-133, Audits of State, Local Governments, and Non-Profit Organizations, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Schnurr & Company, LLP

Fort Dodge, Iowa
November 9, 2006

KEYSTONE AREA EDUCATION AGENCY 1

MANAGEMENT'S DISCUSSION AND ANALYSIS

Keystone Area Education Agency 1 provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the fiscal year ended June 30, 2006. We encourage readers to consider this information in conjunction with the Agency's financial statements which follow.

2006 FINANCIAL HIGHLIGHTS

General Fund revenues in 2006 (FY06) were \$20,451,937 while General Fund expenditures for FY06 were \$20,245,156. Financing uses for FY06 were \$455,231. This resulted in a decrease in the Agency's General Fund balance from \$1,555,417 in FY05 to \$1,306,967 in FY06, a 16% decrease from the prior year.

USING THIS ANNUAL REPORT

The annual report consists of a series of financial statements and other information, as follows:

- Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the agency's financial activities.
- The Government-wide Financial Statements consist of a statement of net assets and a statement of activities. These provide information about the activities of Keystone Area Education Agency as a whole and present an overall view of the Agency's finances.
- The Fund Financial Statements tell how governmental services were financed in the short term as well as what remains for future spending. Fund financial statements report the Agency's operations in more detail than the government-wide statements by providing information about the most significant funds.
- Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements.
- Required Supplementary Information further explains and supports the financial statements with a comparison of the Agency's budget for the year, and Supplementary Information provides detailed information about the non-major funds.

MANAGEMENT'S DISCUSSION AND ANALYSIS

USING THIS ANNUAL REPORT (Continued)

Reporting the Agency as a Whole

Government-wide Financial Statements

The Government-wide statements report information about the Agency as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the Agency's assets and liabilities. All of the current year revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two Government-wide statements report the Agency's net assets and how they have changed. Net assets — the difference between the agency's assets and liabilities — are one way to measure the Agency's financial health or position.

- Over time, increases or decreases in the Agency's net assets are an indicator of whether financial position is improving or deteriorating, respectively.
- To assess the Agency's overall health, additional non-financial factors, such as changes in the Agency's property tax base and the condition of its facilities, need to be considered.

In the Government-wide financial statements, the Agency's activities are divided into two categories:

- *Governmental activities:* Most of the Agency's basic services are included here, such as regular and special education instruction, student and instructional staff support services, and administration. Local school districts, federal and state aid finance most of these activities.
- *Business-type activities:* The Agency coordinates the cooperative purchasing program, but the vendors direct bill the school districts, so this fund is no longer necessary.

Fund Financial Statements

The fund financial statements provide detailed information about the Agency's funds, focusing on its most significant or "major" funds-not the Agency as a whole. Funds are accounting devices the Agency uses to keep track of specific sources of funding and spending on particular programs. Some funds are required by state law or by bond covenants. The Agency establishes other funds to control and manage money for particular purposes, such as accounting for major construction projects or to show that it is properly using certain revenues, such as federal grants.

MANAGEMENT'S DISCUSSION AND ANALYSIS
USING THIS ANNUAL REPORT (Continued)

Reporting the Agency as a Whole (Continued)

Fund Financial Statements (continued)

The Agency has two kinds of funds:

1. Governmental funds account for most of the Agency's basic services. These focus on how cash and other financial assets that can readily be converted to cash flow in and out and the balances left at year-end that are available for spending. Consequently, the governmental fund statements provide a detailed short-term view that helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the Agency's programs. Because this information does not encompass the additional long-term focus of the Government-wide statements, additional information at the bottom of the governmental fund statements explains the relationship or differences between the two statements. The Agency's governmental funds include: 1) the General Fund, 2) the Special Revenue Fund, and 3) the Debt Service Fund.

The governmental funds required financial statements include a balance sheet and a statement of revenues, expenditures and changes in fund balances.

2. Proprietary funds account for services for which the Agency charges a fee. Proprietary funds are reported in the same way as the Government-wide statements. The Agency's enterprise fund, one type of proprietary fund, is the same as its business-type activities, but provides more detail and additional information, such as cash flows. The Agency currently has one Enterprise Fund, the Cooperative Purchasing Fund.

This fund was not necessary in FY05 or FY06 due to the vendors direct billing the school districts.

MANAGEMENT'S DISCUSSION AND ANALYSIS

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of financial position. Keystone Area Education Agency's net assets at the end of fiscal year 2006 totaled approximately \$1.9 million. The analysis that follows provides a summary of the Agency's net assets at June 30, 2006 for the governmental activities.

Condensed Statement				
	Governmental Activities		Business-type Activities	
	2005	2006	2005	2006
Current and other assets	\$ 6,713,615	\$ 8,398,333	\$ -	
Capital assets	4,954,691	4,811,748	-	
Total assets	11,668,306	13,210,081	-	-
Long-term obligations	4,537,050	4,636,169	-	-
Other liabilities	4,739,019	6,661,426	-	
Total liabilities	9,276,069	11,297,595	-	-
Net assets:				
Invested in capital assets, net of related debt	784,288	783,845	-	
Restricted	431,718	429,940	-	
Unrestricted	1,176,231	698,701	-	
Total net assets	\$ 2,392,237	\$ 1,912,486	\$ -	\$ -

of Net Assets

Total Agency		Percentage Change (%)
2005	2006	2005-2006
\$ 6,713,615	\$ 8,398,333	25.1
4,954,691	4,636,169	(6.4)
11,668,306	13,210,081	13.2
4,537,050	4,636,169	2.2
4,739,019	6,661,426	40.6
9,276,069	11,297,595	21.8
784,288	783,845	(0.1)
431,718	429,940	(0.4)
1,176,231	698,701	(40.6)
\$ 2,392,237	\$ 1,912,486	(20.1)

MANAGEMENT'S DISCUSSION AND ANALYSIS

GOVERNMENT-WIDE FINANCIAL ANALYSIS (Continued)

The following analysis shows the changes in net assets for the year ended June 30, 2006:

	Changes in			
	Governmental Activities		Business-type Activities	
	2005	2006	2005	2006
Revenues:				
Program revenues:				
Charges for service	\$ 877,130	\$ 671,789	\$ -	\$ -
Operating grants and contributions	8,843,799	9,408,104	-	-
General revenues:				
Property taxes	5,405,216	5,492,301	-	-
State foundation aid	4,586,033	4,828,923	-	-
Unrestricted investment earnings	114,560	197,971	-	-
Gas tax refund	2,220	-	-	-
Total revenues	19,828,958	20,599,088	-	-
Program expenses:				
Instruction	121,637	294,757	-	-
Student support services	9,304,874	9,525,936	-	-
Instructional staff support services	5,521,884	5,762,343	-	-
General administration	2,966,848	3,112,269	-	-
Business administration	783,463	1,235,980	-	-
Plant operations and maintenance	844,368	755,680	-	-
Central and other support services	178,419	2,421	-	-
Community service operations	-	85,713	-	-
Facilities acquisition and construction	-	127,727	-	-
Interest on long-term debt	182,366	176,013	-	-
Total expenses	19,903,859	21,078,839	-	-
Decrease in net assets	(74,901)	(479,751)	-	-
Net assets beginning of year	2,467,138	2,392,237	-	-
Net assets end of year	\$ 2,392,237	\$ 1,912,486	\$ -	\$ -

Net Assets

Total Agency		Percentage
2005	2006	Change (%)
		2005-2006
\$ 877,130	\$ 671,789	(23.4)
8,843,799	9,408,104	6.4
5,405,216	5,492,301	1.6
4,586,033	4,828,923	5.3
114,560	197,971	72.8
2,220	-	(100.0)
19,828,958	20,599,088	3.9
121,637	294,757	142.3
9,304,874	9,525,936	2.4
5,521,884	5,762,343	4.4
2,966,848	3,112,269	4.9
783,463	1,235,980	57.8
844,368	755,680	(10.5)
178,419	2,421	(98.6)
-	85,713	100.0
-	127,727	100.0
182,366	176,013	(3.5)
19,903,859	21,078,839	5.9
(74,901)	(479,751)	540.5
2,467,138	2,392,237	(3.0)
\$ 2,392,237	\$ 1,912,486	(20.1)

MANAGEMENT'S DISCUSSION AND ANALYSIS

GOVERNMENT-WIDE FINANCIAL ANALYSIS (Continued)

Operating grants and contributions from local, state, and federal sources account for 46% of the total revenue. The Agency's expenses primarily relate to instruction and support services, which account for 74% of the total expenses.

Governmental Activities

Revenues for governmental activities were \$20,599,088 and expenses were \$21,078,839.

FINANCIAL ANALYSIS OF THE AGENCY'S FUNDS

As previously noted, Keystone Area Education Agency uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Agency's governmental funds reported a combined fund balance that decreased from \$1,974,596 to \$1,736,907. The primary reason for the decrease in combined fund balances in FY 06 was the on-going reduction in state aid of \$1,376,547 in the special education services division. Because of the increased demands of the *No Child Left Behind Act* and the *Individuals with Disabilities Education Act*, it was necessary to utilize fund balance to replace the reduced state aid to meet service needs of the local school districts and their students.

Governmental Fund Highlights

The Agency's general fund financial position is being eroded because of reduced state aid and increasing service needs and demands that are being imposed by federal legislation such as the *No Child Left Behind Act* and the *Individuals with Disabilities Education Act*.

Budgetary Highlights

The Agency's Board of Directors annually adopts a budget on a basis consistent with U.S. generally accepted accounting principles. Although the budget document presents functional disbursements by fund, the legal level of control is at the total expenditure level, not at the fund or fund type level. After required public notice and State Board review, the State Board either approves the budget or returns it with comments. Any unapproved budget must be resubmitted to the State Board for final approval. The budget may be amended during the year utilizing procedures prescribed by the State Board. Over the course of the year, the Agency amended its annual operating budget one time to reflect additional revenue and expenditures associated with the additional services needed and provided to the local school districts. A schedule showing the original and final budget amounts compared to the Agency's actual financial activity is included in the required supplementary information section of this report.

MANAGEMENT'S DISCUSSION AND ANALYSIS

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

On June 30, 2006, the Agency had invested \$4.8 million, net of accumulated depreciation, in a broad range of capital assets, including land, building, computers, Media lending library and audio-visual equipment. Keystone Area Education Agency had depreciation expense of \$503,953 in FY06 and total accumulated depreciation of \$5.4 million on June 30, 2006. More detailed information about capital assets is available in Note 4 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

At the time these financial statements were prepared and audited, the Agency was aware of existing circumstances that could significantly affect its financial health in the future:

- The state aid reduction of \$1,376,547 has been reduced by \$262,566 to \$1,113,981. This additional funding will assist the Agency as it attempts to meet its service requirements while maintaining an acceptable solvency condition. Collective bargaining agreements with the Agency's two bargaining units were positive for the Agency's financial condition while providing for adequate increases in compensation for employees. A very small increase in health and dental insurance rates was the primary variable that contributed to these positive agreements.
- Collective bargaining settlements that continue to exceed increases in controlled funding as well as other funding is an on-going concern that will be addressed either through erosion of financial position or erosion of services to schools and children. All of the aforementioned variables must be balanced with the need to compensate the Agency's employees in a competitive manner.
- Declining enrollment is an on-going concern, since controlled funding is driven by per pupil amounts, plus allowable growth, multiplied by the number of students. Although student population is declining, student needs are increasing.
- As an Agency, we must explore options to provide more effective, efficient and economical service within an environment of declining enrollment, reduced state aid, a very competitive labor market for the professional employees that we need, and the requirement to maintain financial solvency.

CONTACTING THE AGENCY'S FINANCIAL MANAGEMENT

This financial report is designed to provide the Agency's citizens, taxpayers, customers, investors and creditors with a general overview of the Agency's finances and to demonstrate the Agency's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Business Manager's Office of Keystone Area Education Agency, 1400 2nd St N.W., Elkader, Iowa, 52043-9564.

KEYSTONE AREA EDUCATION AGENCY 1

BASIC FINANCIAL STATEMENTS

STATEMENT OF NET ASSETS

June 30, 2006

	Governmental Activities	Business-Type Activities	Total
Assets			
Cash	\$ 1,766,445	\$ -	\$ 1,766,445
Receivables:			
Accounts	143,137	-	143,137
Due from other governments	1,418,238	-	1,418,238
Inventories	31,617	-	31,617
Prepaid expenses	132,321	-	132,321
Restricted ISCAP assets:			
Investments	4,876,245	-	4,876,245
Accrued interest receivable	30,330	-	30,330
Capital assets (net of accumulated depreciation)	4,811,748	-	4,811,748
Total assets	13,210,081	-	13,210,081
Liabilities			
Accounts payable	336,729	-	336,729
Salaries and benefits payable	1,268,603	-	1,268,603
Interest payable	56,249	-	56,249
ISCAP warrants payable	4,876,000	-	4,876,000
Deferred revenue:			
Federal	61,211	-	61,211
Miscellaneous	62,634	-	62,634
Long-term liabilities			
Portion due or payable within one year:			
Capital leases	297,500	-	297,500
Compensated absences	251,224	-	251,224
Portion due or payable after one year:			
Capital leases	3,730,403	-	3,730,403
Compensated absences	357,042	-	357,042
Total liabilities	11,297,595	-	11,297,595

(Continued on next page)

KEYSTONE AREA EDUCATION AGENCY 1**Exhibit A
(Continued)****STATEMENT OF NET ASSETS
June 30, 2006**

	Governmental Activities	Business-Type Activities	Total
Total Liabilities	\$ 11,297,595	\$ -	\$ 11,297,595
Net Assets			
Invested in capital assets, net of related debt	783,845	-	783,845
Restricted for:			
Debt service	421,189	-	421,189
Capital project	8,751	-	8,751
Unrestricted	698,701	-	698,701
Total net assets	1,912,486	-	1,912,486
Total liabilities and net assets	\$ 13,210,081	\$ -	\$ 13,210,081

See Notes to Financial Statements.

KEYSTONE AREA EDUCATION AGENCY 1

STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

	Program Revenues	
	Charges for	Operating
Expenses	Services	Grants and
		Contributions
Functions/Programs:		
Governmental Activities:		
Instruction	\$ 294,757	\$ 294,653
Student support services	9,525,936	8,887,012
Instructional staff support services	5,762,343	226,439
General administration	3,112,269	-
Business administration	1,235,980	-
Plant operations and maintenance	755,680	-
Central and other support services	2,421	-
Community service operations	85,713	-
Facilities acquisition and construction	127,727	-
Interest on long-term debt	176,013	-
Total	\$ 21,078,839	\$ 9,408,104

General revenues:

Property taxes
State foundation aid
Unrestricted investment earnings

Change in net assets

Net assets beginning of year

Net assets end of year

See Notes to Financial Statements.

Exhibit B

Net (Expense) Revenue and Changes in Net Assets		
Governmental Activities	Business-Type Activities	Total
\$ (104)	\$ -	\$ (104)
(575,522)	-	(575,522)
(5,273,097)	-	(5,273,097)
(3,112,269)	-	(3,112,269)
(900,189)	-	(900,189)
(745,891)	-	(745,891)
(2,421)	-	(2,421)
(85,713)	-	(85,713)
(127,727)	-	(127,727)
(176,013)	-	(176,013)
(10,998,946)	-	(10,998,946)
5,492,301	-	5,492,301
4,828,923	-	4,828,923
197,971	-	197,971
(479,751)	-	(479,751)
2,392,237	-	2,392,237
<u>\$ 1,912,486</u>	<u>\$ -</u>	<u>\$ 1,912,486</u>

KEYSTONE AREA EDUCATION AGENCY 1

Exhibit C

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2006

	Nonmajor Governmental		
	General	Funds	Total
Assets			
Cash	\$ 1,293,427	\$ 473,018	\$ 1,766,445
Receivables:			
Accounts	143,137	-	143,137
Due from other governments	1,418,238	-	1,418,238
Inventories	31,617	-	31,617
Prepaid expenditures	132,321	-	132,321
Restricted ISCAP assets:			
Investments	4,876,245	-	4,876,245
Accrued interest receivable	30,330	-	30,330
Total assets	\$ 7,925,315	\$ 473,018	\$ 8,398,333
Liabilities and Fund Balances			
Accounts payable	\$ 329,737	\$ 6,992	\$ 336,729
Salaries and benefits payable	1,260,420	8,183	1,268,603
Interest payable	28,346	27,903	56,249
ISCAP warrants payable	4,876,000	-	4,876,000
Deferred revenue:			
Federal	61,211	-	61,211
Miscellaneous	62,634	-	62,634
Total liabilities	6,618,348	43,078	6,661,426
Fund balances:			
Reserved for:			
Inventories	31,617	-	31,617
Prepaid expenditures	132,321	-	132,321
Phase III	3,759	-	3,759
Media materials	476	-	476
Other	61,377	-	61,377
Unreserved:			
Designated for subsequent year's expenditures	701,807	-	701,807
Undesignated	375,610	429,940	805,550
Total fund balances	1,306,967	429,940	1,736,907
Total liabilities and fund balances	\$ 7,925,315	\$ 473,018	\$ 8,398,333

See Notes to Financial Statements.

**RECONCILIATION OF BALANCE SHEET--
GOVERNMENTAL FUNDS TO THE STATEMENT OF NET ASSETS
June 30, 2006**

Total governmental fund balances (page 14)	\$ 1,736,907
<i>Amounts reported for governmental activities in the Statement of Net Assets are different because:</i>	
Capital assets used in governmental activities are not current financial resources and, therefore, are not reported in the funds. The cost of assets is \$10,190,974 and the accumulated depreciation is \$5,379,226.	4,811,748
Long-term liabilities, including capital leases and compensated absences, are not due and payable in the current period and, therefore, are not reported in the funds.	<u>(4,636,169)</u>
Net assets of governmental activities (page 12)	<u><u>\$ 1,912,486</u></u>

See Notes to Financial Statements.

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES -- GOVERNMENTAL FUNDS
Year Ended June 30, 2006**

	Nonmajor Governmental		
	General	Funds	Total
Revenues:			
Local sources	\$ 6,550,924	\$ 1,770	\$ 6,552,694
State sources	5,030,498	145,381	5,175,879
Federal sources	8,870,515	-	8,870,515
Total revenues	20,451,937	147,151	20,599,088
Expenditures:			
Current:			
Instruction	169,827	124,826	294,653
Student support services	9,438,835	-	9,438,835
Instructional staff support services	5,698,212	1,066	5,699,278
General administration	2,995,657	9,913	3,005,570
Business administration	1,192,424	-	1,192,424
Plant operations and maintenance	661,952	9,576	671,528
Central and other support services	2,421	-	2,421
Community service operations	85,828	-	85,828
Facilities acquisition and construction	-	127,727	127,727
Debt service	-	453,513	453,513
Total expenditures	20,245,156	726,621	20,971,777
Excess (deficiency) of revenues over (under) expenditures	206,781	(579,470)	(372,689)
Other financing sources (uses):			
Capital lease proceeds	-	135,000	135,000
Transfers in	-	455,231	455,231
Transfers out	(455,231)	-	(455,231)
Total financing sources (uses)	(455,231)	590,231	135,000
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(248,450)	10,761	(237,689)
Fund balances, beginning of year	1,555,417	419,179	1,974,596
Fund balances, end of year	\$ 1,306,967	\$ 429,940	\$ 1,736,907

See Notes to Financial Statements.

**RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES --
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
Year Ended June 30, 2006**

Net change in fund balances - total governmental funds (page 16) \$ (237,689)

*Amounts reported for governmental activities in the
statement of activities are different because:*

Governmental funds report capital outlays as expenditures while governmental activities report depreciation expense to allocate those expenditures over the estimated useful lives of the assets. Depreciation expense exceeded capital outlay in the current year as follows:

Expenditures for capital assets	\$ 397,008	
Depreciation expense	<u>(503,953)</u>	(106,945)

In the Statement of Activities, the loss on the disposition of capital assets is reported, whereas in the governmental funds, the proceeds from the sale increase financial resources (35,998)

Repayment of long-term debt principal is an expenditure in the governmental funds, but reduces long-term liabilities in the statement of net assets and does not affect the statement of activities. 277,500

Capital leases provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. (135,000)

Compensated absences expense reported in the statement of activities does not require the use of current financial resources and, therefore, is not reported as an expenditure in the governmental funds. (241,619)

Change in net assets of governmental activities (page 13) \$ (479,751)

See Notes to Financial Statements.

KEYSTONE AREA EDUCATION AGENCY 1

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Keystone Area Education Agency 1 is an intermediate school corporation established to identify and serve children who require special education. The Agency also provides media services and education support services. These programs and support services are provided to 25 school districts and private schools in an eight-county area. The Agency is governed by a Board of Directors whose members are elected on a non-partisan basis.

The Agency's financial statements are prepared in conformity with U. S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board.

A. Reporting Entity:

For financial reporting purposes, Keystone Area Education Agency 1 has included all funds, organizations, agencies, boards, commissions and authorities. The Agency has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Agency are such that exclusion would cause the Agency's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Agency to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Agency. The Keystone Area Education Agency 1 has no component units which meet the Governmental Accounting Standards Board criteria.

B. Basis of Presentation:

Government-wide Financial Statements – The Statement of Net Assets and the Statement of Activities report information on all of the activities of the Agency. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The Statement of Net Assets presents the Agency's nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributable to the acquisition, construction, or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

B. Basis of Presentation (continued):

Government-wide Financial Statements (continued) – The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and 2) grants, contributions and interest that are restricted to meeting the operational or capital requirements of a particular function. Unrestricted interest income and other items not properly included among program revenues are reported instead as general revenues.

Fund Financial Statements – Separate financial statements are provided for governmental and proprietary funds. Major individual governmental funds are reported as separate columns in the fund financial statements. All remaining governmental funds are aggregated and reported as other nonmajor governmental funds.

The Agency reports the following major governmental fund:

The General Fund is the general operating fund of the Agency. All general revenues and other revenues that are not allocated by law or contractual agreement to some other fund are accounted for in this fund. From the fund are paid the general operating expenditures, including instructional, support and other costs.

C. Measurement Focus and Basis of Accounting:

The Government-wide financial statements and the proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been satisfied.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Agency considers revenues to be available if they are collected within 60 days after year-end.

Intergovernmental revenues (shared revenues, grants and reimbursements from other governments) and interest associated with the current fiscal period are all considered to be susceptible to accrual. All other revenue items are considered to be measurable and available only when cash is received by the Agency.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, principal and interest on long-term debt, claims and judgments and compensated absences are recognized as expenditures only when payment is due. Capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

D. Assets, Liabilities and Fund Equity:

Cash – Cash includes amounts in demand deposits, money market funds and certificates of deposit.

Inventories – Inventories are stated at cost using the first-in, first-out method and consist of expendable supplies and materials. The cost of these items is recorded as an expenditure at the time of consumption.

Capital Assets – Capital assets are recorded at historical cost. Donated capital assets are recorded at estimated fair market value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Capital assets are defined by the Agency as assets with initial, individual costs in excess of the following thresholds and estimated useful lives in excess of two years.

Land	No lower limit
Buildings	\$ 5,000
Improvements other than buildings	5,000
Furniture and equipment	1,000
Library books	Aggregated annual purchases

Property, furniture and equipment are depreciated using the straight-line method of depreciation over the following useful lives:

<u>Asset Class</u>	<u>Estimated Useful Lives (In Years)</u>
Buildings	25
Improvements other than buildings	20
Furniture and equipment	5-20
Library books	5

Salaries and Benefits Payable – Payroll and related expenses for teachers with annual contracts corresponding to the current school year, which are payable in July and August, have been accrued as liabilities.

Deferred Revenue – Deferred revenue represents an excess of cash advances by the funding source over accrued expenditures at year-end.

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

D. Assets, Liabilities and Fund Equity (continued):

Compensated Absences – Agency employees accumulate a limited amount of earned but unused vacation and sick leave hours for subsequent use or for payment upon termination, death or retirement. A liability has been recorded in the Statement of Net Assets representing the Agency's commitment to fund non-current compensated absences. This liability has been computed based on rates of pay in effect at June 30, 2006. The compensated absences liability attributable to the governmental activities will be paid primarily by the General and Special Revenue Funds.

Long-term Liabilities – In the Government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the governmental activities column in the Statement of Net Assets.

Fund Balances – In the governmental fund financial statements, reservations of fund balance are reported for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose.

Restricted Net Assets – In the Government-wide Statement of Net Assets, net assets are reported as restricted when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors or laws and regulations of other governments or imposed by law through constitutional provisions or enabling legislation.

Note 2. Cash and Pooled Investment

The Agency's deposits in banks at June 30, 2006 were entirely covered by Federal depository insurance or by the state sinking fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Agency is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Directors; prime eligible bankers' acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

Interest rate risk. The Agency's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days but the maturities shall be consistent with the needs and use of the Agency.

NOTES TO FINANCIAL STATEMENTS

Note 3. Iowa School Cash Anticipation Program (ISCAP)

The Agency participates in the Iowa Schools Cash Anticipation Program (ISCAP). ISCAP is a program of the Iowa Association of School Boards, and is designed to provide funds to participating entities during periods of cash deficits. ISCAP is funded by a semiannual issuance of anticipatory warrants, which mature as noted below. The warrant sizing of each participating entity is based on a projection of cash flow needs during the semiannual period. ISCAP accounts are maintained for each participating entity and are provided monthly statements regarding their cash balance, interest earnings, and amounts available for withdrawal for each outstanding series of warrants. Bankers Trust Co., NA is trustee of the program. These accounts are reflected as restricted assets on the Statement of Net Assets and Balance Sheet.

A summary of the Agency's participation in ISCAP as of June 30, 2006 is as follows:

Series	Warrant Date	Final Warrant Maturity	Investments	Accrued Interest Receivable	Warrants Payable	Accrued Interest Payable
2005-2006B	1/26/2006	1/26/2007	\$ 1,444,022	\$ 29,263	\$ 1,439,000	\$ 27,472
2006-2007A	6/28/2005	6/28/2006	3,432,223	1,067	3,437,000	874
			<u>\$ 4,876,245</u>	<u>\$ 30,330</u>	<u>\$ 4,876,000</u>	<u>\$ 28,346</u>

The Agency pledges its state foundation aid payments and General Fund receipts as security for warrants issued. Repayments must be made when General Fund receipts are received. If a balance is outstanding on the last date the funds are available to be drawn, then the Agency must repay the outstanding withdrawal from its General Fund receipts. In addition, the Agency must make minimum warrant repayments on the 25th of each month immediately following the final date that the warrant proceeds may be used in an amount equal to 25% of the warrant amount. ISCAP advance activity in the General Fund for the year ended June 30, 2006 is as follows:

Series	Balance Beginning of Year	Advances Received	Advances Repaid	Balance End of Year
2005-2006B	\$ -	\$ -	\$ -	\$ -
2006-2007A	-	-	-	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The warrants bear an interest rate and the available proceeds of the warrants are invested at an interest rate as shown below:

Series	Interest Rates on Warrants	Interest Rates on Investments
2005-2006B	4.500%	4.772%
2006-2007A	4.500%	5.676%

NOTES TO FINANCIAL STATEMENTS

Note 4. Capital Assets

Capital assets activity for the year ended June 30, 2006 is as follows:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Governmental activities:				
Capital assets not being depreciated:				
Land	\$ 343,373	\$ -	\$ -	\$ 343,373
Total capital assets not being depreciated	343,373	-	-	343,373
Capital assets being depreciated:				
Buildings	5,500,704	124,046	-	5,624,750
Improvements other than buildings	93,000	-	-	93,000
Furniture and equipment	845,900	25,129	12,294	858,735
Library books	3,336,604	247,833	313,321	3,271,116
Total capital assets being depreciated	9,776,208	397,008	325,615	9,847,601
Less accumulated depreciation for:				
Buildings	2,118,864	189,855	-	2,308,719
Improvements other than buildings	41,850	4,185	-	46,035
Furniture and equipment	634,771	42,639	7,628	669,782
Library books and films	2,369,405	267,274	281,989	2,354,690
	5,164,890	503,953	289,617	5,379,226
Total capital asset being depreciated, net	4,611,318	(106,945)	35,998	4,468,375
Governmental activities capital assets, net	\$ 4,954,691	\$ (106,945)	\$ 35,998	\$ 4,811,748

Depreciation expense was charged to functions of the Agency as follows:

Governmental activities:	
Instruction	\$ -
Student support services	5,172
Instructional staff support services	281,262
General administration	10,318
Business administration	11,134
Plant operations and maintenance	196,067
Central and other support services	-
Total governmental activities depreciation expense	<u>\$ 503,953</u>

NOTES TO FINANCIAL STATEMENTS

Note 5. Changes in Long-term Liabilities

A summary of changes in long-term liabilities for the year ended June 30, 2006 is as follows:

	Balance Beginning of Year	Additions	Reductions	Balance End of Year	Due Within One Year
Capital leases	\$ 4,170,403	\$ 135,000	\$ 277,500	\$ 4,027,903	\$ 297,500
Compensated absences	366,647	374,720	133,101	608,266	251,224
	<u>\$ 4,537,050</u>	<u>\$ 509,720</u>	<u>\$ 410,601</u>	<u>\$ 4,636,169</u>	<u>\$ 548,724</u>

Capital leases:

The Agency is obligated under certain leases accounted for as capital leases. Fixed assets under capital leases included in buildings totaled \$4,822,173 at June 30, 2006. The leases end at various dates through May 1, 2017 at interest rates of 4.25% and 4.37%. The following is a schedule of future minimum lease payments required under capital leases as of June 30, 2006:

Year Ending June 30,	Principal	Interest	Total
2007	\$ 297,500	\$ 167,348	\$ 464,848
2008	260,000	155,780	415,780
2009	290,000	144,411	434,411
2010	315,000	131,873	446,873
2011	345,000	118,167	463,167
2012 and later years	2,520,403	401,833	2,922,236
Total	<u>\$ 4,027,903</u>	<u>\$ 1,119,412</u>	<u>\$ 5,147,315</u>

Payments under these agreements for the year ended June 30, 2006, including interest of \$177,731, totaled \$455,231.

NOTES TO FINANCIAL STATEMENTS

Note 6. Operating Leases

The Agency has leases for copiers and other related equipment that have been classified as operating leases and accordingly, all rents are charged to expenditures as incurred. The leases expire on dates ranging from June 2007 through August 2011.

The following is a schedule by year of future minimum rental payments required under operating leases which have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2006.

Year Ending June 30,	Amount
2007	\$ 118,647
2008	38,496
2009	23,601
2010	22,601
2011	9,417
	<u>\$ 212,762</u>

Total rental expenditures for the year ended June 30, 2006 for all operating leases, except those with terms of a month or less that were not renewed, was \$109,230.

Note 7. Pension and Retirement Benefits

The Agency contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by State statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P. O. Box 9117, Des Moines, Iowa 50306-9117.

Plan members are required to contribute 3.70% of their annual covered salary and the Agency is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Agency's contribution to IPERS for the years ended June 30, 2006, 2005 and 2004 were \$666,971, \$626,564 and \$610,308, respectively, equal to the required contributions for each year.

Note 8. Risk Management

The Agency is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. The Agency assumes liability for any deductibles and claims in excess of coverage limitations. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

KEYSTONE AREA EDUCATION AGENCY 1

REQUIRED SUPPLEMENTARY INFORMATION

KEYSTONE AREA EDUCATION AGENCY 1**STATEMENT OF REVENUES, EXPENDITURES/EXPENSES
AND CHANGES IN BALANCES -- BUDGET AND ACTUAL
ALL GOVERNMENTAL FUNDS AND PROPRIETARY FUND
Required Supplementary Information
Year Ended June 30, 2006**

	Governmental Fund Types Actual	Proprietary Fund Types Actual	Total Actual
Revenues:			
Local sources	\$ 6,552,694	\$ -	\$ 6,552,694
State sources	5,175,879	-	5,175,879
Federal sources:	8,870,515	-	8,870,515
Total revenues	20,599,088	-	20,599,088
Expenditures/Expenses:			
Current:			
Instruction	294,653	-	294,653
Student support services	9,438,835	-	9,438,835
Instructional staff support services	5,699,278	-	5,699,278
General administration	3,005,570	-	3,005,570
Business administration	1,192,424	-	1,192,424
Plant operations and maintenance	671,528	-	671,528
Central and other support services	2,421	-	2,421
Community service operations	85,828	-	85,828
Facilities acquisition and construction	127,727	-	127,727
Debt service	453,513	-	453,513
Total expenditures/expenses	20,971,777	-	20,971,777
Excess (deficiency) of revenues over (under) expenditures/expenses	(372,689)	-	(372,689)
Other financing sources (uses)	135,000	-	135,000
Excess (deficiency) of revenues and other financing sources over (under) expenditures/ expenses and other financing (uses)	(237,689)	-	(237,689)
Balance, beginning of year	1,974,596	-	1,974,596
Balance, end of year	<u>\$ 1,736,907</u>	<u>\$ -</u>	<u>\$ 1,736,907</u>

See accompanying Independent Auditor's Report.

Budget		Final to Actual Variance - Favorable (Unfavorable)
Original	Final	
\$ 6,400,639	\$ 6,280,399	\$ 272,295
6,160,291	5,174,417	1,462
8,979,459	9,198,545	(328,030)
21,540,389	20,653,361	(54,273)
141,053	130,326	(164,327)
10,128,173	9,647,846	209,011
6,522,949	6,436,392	737,114
3,135,809	3,047,712	42,142
612,271	860,313	(332,111)
615,123	778,823	107,295
-	-	(2,421)
-	88,010	2,182
-	135,000	7,273
385,011	455,525	2,012
21,540,389	21,579,947	608,170
-	(926,586)	553,897
-	234,484	(99,484)
-	(692,102)	454,413
1,974,596	1,974,596	-
\$ 1,974,596	\$ 1,282,494	\$ 454,413

KEYSTONE AREA EDUCATION AGENCY 1
June 30, 2006

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION – BUDGETARY REPORTING

This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for the General Fund and each major Special Revenue Fund.

The Agency's Board of Directors annually prepares a budget on a basis consistent with U. S. generally accepted accounting principles. Although the budget document presents functional disbursements by fund, the legal level of control is at the total expenditure/expense level, not by fund. After required public notice and hearing in accordance with the Code of Iowa, the Board submits its budget to the State Board of Education. The State Board reviews the proposed budget and either grants approval or returns it without approval with comments. Any unapproved budget must be resubmitted to the State Board for final approval. The budget may be amended during the year utilizing procedures prescribed by the State Board.

OTHER SUPPLEMENTARY INFORMATION

COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
Year Ended June 30, 2006

	Special Revenue		Debt	
	Juvenile	Capital Project	Service	Total
Assets	Home			
Cash	\$ 15,117	\$ 8,809	\$ 449,092	\$ 473,018
Total assets	\$ 15,117	\$ 8,809	\$ 449,092	\$ 473,018
Liabilities and Fund Balances				
Liabilities:				
Accounts payable	\$ 6,934	\$ 58	\$ -	\$ 6,992
Interest payable	-	-	27,903	27,903
Salaries and benefits payable	8,183	-	-	8,183
Total liabilities	15,117	58	27,903	43,078
Fund balances:				
Unreserved, undesignated fund balance	-	8,751	421,189	429,940
Total liabilities and fund balances	\$ 15,117	\$ 8,809	\$ 449,092	\$ 473,018

See Accompanying Independent Auditor's Report.

**COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
NONMAJOR GOVERNMENTAL FUNDS
Year Ended June 30, 2006**

	Special Revenue		Debt Service	
	Juvenile	Capital Project		Total
	Home			
Revenues:				
Local sources	\$ -	\$ 1,478	\$ 292	\$ 1,770
State sources	145,381	-	-	145,381
Total revenues	145,381	1,478	292	147,151
Expenditures:				
Current:				
Instruction	124,826	-	-	124,826
Instructional staff support services	1,066	-	-	1,066
General administration	9,913	-	-	9,913
Plant operations and maintenance	9,576	-	-	9,576
Facilities acquisition and construction	-	127,727	-	127,727
Debt service	-	-	453,513	453,513
Total expenditures	145,381	127,727	453,513	726,621
Deficiency of revenues under expenditures	-	(126,249)	(453,221)	(579,470)
Other financing sources:				
Capital lease proceeds	-	135,000	-	135,000
Transfers in	-	-	455,231	455,231
	-	135,000	455,231	590,231
Excess of revenues and other financing sources over expenditures	-	8,751	2,010	10,761
Fund balances beginning of year	-	-	419,179	419,179
Fund balances end of year	\$ -	\$ 8,751	\$ 421,189	\$ 429,940

See accompanying Independent Auditor's Report.

KEYSTONE AREA EDUCATION AGENCY 1

Schedule 3

**SCHEDULE OF REVENUES BY SOURCE AND
EXPENDITURES BY FUNCTION
ALL GOVERNMENTAL FUND TYPES
For the Last Four Years**

	Modified Accrual Basis			
	Years ended June 30,			
	2006	2005	2004	2003
Revenues:				
Local	\$ 6,552,694	\$ 6,402,127	\$ 6,135,625	\$ 5,926,165
State	5,175,879	4,923,883	4,891,443	5,588,592
Federal	8,870,515	8,502,948	7,665,784	6,644,135
Total	\$ 20,599,088	\$ 19,828,958	\$ 18,692,852	\$ 18,158,892
Expenditures				
Instruction	\$ 294,653	\$ 121,543	\$ 117,248	\$ 94,162
Student support services	9,438,835	9,322,347	8,422,985	7,666,455
Instructional staff support services	5,699,278	5,402,081	5,624,220	5,242,624
General administration	3,005,570	2,979,545	2,691,044	2,618,878
Business administration	1,192,424	758,353	571,982	476,412
Plant operations and	671,528	630,566	768,618	565,719
Central and other support services	2,421	192,599	296,276	320,905
Community service operations	85,828	-	-	-
Facilities acquisition and construction	127,727	-	-	-
Debt service	453,513	361,701	345,683	363,047
Total expenditures	\$ 20,971,777	\$ 19,768,735	\$ 18,838,056	\$ 17,348,202

See accompanying Independent Auditor's Report.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2006

Project Title	CFDA Number	Pass-through Grantor's Number	Expenditures
Indirect:			
U. S. Department of Education:			
Passed-through Iowa Department of Education:			
Part B, Education of Handicapped act (EHA)			
Special Education - Grants to States:			
Basic Entitlement 2006	84.027	6KB-01	\$ 1,860,749
Basic Entitlement 2006	84.027	050601	5,243,122
Supplemental Support	84.027	4K72-01	118,503
Parent Coordinator Grant 2006	84.027	57401	93,008
Diagnostic Evaluation 2006	84.027	5K71	5,545
Para-Educator Projects 2006	84.027	5K76-01	15,258
Learning Supports 2006	84.027	5K60-01	36,157
Conflict Resolution and Mediation	84.027	4K07-01	5,500
Employment Preparation Study	84.027	50905	1,417
Instructional Decision Making	84.027	5K79-01	62,218
Every Child Reads	84.027	G-5K27-1	5,980
			<u>7,447,457</u>
Special Education:			
Grants for Infants and Families with Disabilities			
Part C	84.181	C05-01	<u>185,842</u>
Special Education - Preschool Grants:			
Section 619 Project	84.173	05619-01	<u>312,552</u>
IEP Training Project	84.323	5K77-01	<u>23,950</u>
Iowa Quality Preschool Act	84.323	G-6P13-1	<u>34,204</u>
Crisis Intervention	84.184	Q184E040013	<u>177,801</u>

(Continued on next page)

KEYSTONE AREA EDUCATION AGENCY 1

Schedule 4
(Continued)SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2006

Project Title	CFDA Number	Pass-through Grantor's Number	Expenditures
Indirect (Continued):			
U. S. Department of Education:			
Passed-through Iowa Department of Education:			
Vocational Ed - Basic Grants to States, 05-06	84.048A		\$ 266,700
Service Learning	94.004	06SL001	3,000
Title III - English Language Acquisition	84.365		22,190
English as Second Language	84.215		1,600
Evaluating State Education Tech Program	84.318	58204	30,197
Title 1 - Reading First	84.357		12,393
Enhancing Education Through Technology	84.318		231,369
U. S. Department of Health and Human Services:			
Passed-through Iowa Department of			
Human Services:			
Medicaid Reimbursement:			
Part B	93.778		67,860
Part C	93.778		53,400
			121,260
			\$ 8,870,515

Basis of Presentation: The Schedule of Expenditures of Federal Awards includes the federal grant activity of Keystone Area Education Agency 1 and is presented on the modified accrual basis. The information on this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

See accompanying Independent Auditor's Report.

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors
Keystone Area Education Agency 1
Elkader, Iowa

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of Keystone Area Education Agency 1, as of and for the year ended June 30, 2006, which collectively comprise the Agency's basic financial statements listed in the table of contents, and have issued our report thereon dated November 9, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Agency's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about the Agency's operations for the year ended June 30, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Agency. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

This report, a public record by law, is intended solely for the information and use of the officials, employees and constituents of the Keystone Area Education Agency 1, and other parties to whom Keystone Area Education Agency 1 may report, including federal awarding agencies and pass-through entities. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Keystone Area Education Agency 1 during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

Schnurr & Company, LLP

Fort Dodge, Iowa
November 9, 2006

**INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH
OMB CIRCULAR A-133**

Board of Directors of
Keystone Area Education Agency 1
Elkader, Iowa

Compliance

We have audited the compliance of Keystone Area Education Agency 1 with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2006. The Agency's major federal program is identified in Part 1 of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grant agreements applicable to its major federal program is the responsibility of the Agency's management. Our responsibility is to express an opinion on the Agency's compliance based on our audit.

We conducted our audit of compliance in accordance with U. S. generally accepted auditing standards, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Agency's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Agency's compliance with those requirements.

In our opinion, the Agency complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006.

Internal Control Over Compliance

The management of the Agency is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grant agreements applicable to federal programs. In planning and performing our audit, we considered the Agency's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that non-compliance with applicable requirements of laws, regulations, contracts, and grant agreements caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We noted no matters involving internal control over compliance and its operation that we consider to be material weaknesses.

This report, a public record by law, is intended solely for the information and use of the officials, employees and citizens of the Agency and other parties to whom the Agency may report including federal awarding agencies and pass-through entities. This report is not intended to be and should not be used by anyone other than these specified parties.

Schnurr & Company, LLP

Fort Dodge, Iowa
November 9, 2006

KEYSTONE AREA EDUCATION AGENCY 1

Schedule of Findings and Questioned Costs Year Ended June 30, 2006

Part I: Summary of the Independent Auditor's Results

- (a) An unqualified opinion was issued on the financial statements.
- (b) No reportable conditions in internal control over financial reporting were disclosed.
- (c) The audit did not disclose any noncompliance which is material to the financial statements.
- (d) No reportable conditions in internal control over major programs were disclosed.
- (e) An unqualified opinion was issued on compliance with requirements applicable to each major program.
- (f) The audit did not disclose any audit findings which are required to be reported in accordance with Office of Management and Budget Circular A-133, Section .510(a).
- (g) The major program was:
 - CFDA Number 84.027 - Special Education - Grants to States
- (h) The dollar threshold used to distinguish between Type A and Type B programs was \$300,000.
- (i) Keystone Area Education Agency 1 qualified as a low-risk auditee.

Part II: Findings Related to the General Purpose Financial Statements:

Instances of Non-Compliance:

No matters were reported.

Reportable Conditions:

No matters were noted.

Part III: Findings and Questioned Costs For Federal Awards:

Instances of Non-Compliance:

No matters were reported.

Reportable Conditions:

No matters were noted.

Schedule of Findings and Questioned Costs (Continued)
Year Ended June 30, 2006

Part IV: Other Findings Related to Required Statutory Reporting:

- IV-A-06 Budget: Expenditures during the year ended June 30, 2006 did not exceed the amounts budgeted.
- IV-B-06 Questionable Expenditures: No expenditures that we believe may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979 were noted.
- IV-C-06 Travel Expense: No expenditures of Agency money for travel expenses of spouses of Agency officials or employees were noted.
- IV-D-06 Business Transactions: No business transactions between the Agency and Agency officials or employees were noted.
- IV-E-06 Bond Coverage: Surety bond coverage of Agency officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to ensure that coverage is adequate for current operations.
- IV-F-06 Board Minutes: No transactions requiring Board approval were noted which had not been approved.
- IV-G-06 Deposits and Investments: The Agency complied with the provisions of Chapters 12B and 12C of the Code of Iowa.
- IV-H-06 Certified Annual Report: The Certified Annual Report was filed with the Department of Education. We noted no significant deficiencies in the amounts reported. However, we noted the report was filed subsequent to the due date.
- Recommendation: The Certified Annual Report should be filed timely with the Department of Education.
- Response: We will file the Certified Annual Report timely with the Department of Education.
- Conclusion: Response accepted.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the Keystone Area Education Agency 1 during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

Schnurr & Company, LLP

Fort Dodge, Iowa
November 9, 2006